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Paying for Bank Deposits

Hyman P. Minsky Ph.D.

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I thought it over pretty carefully and then, with some regrets, spent the remainder of that job striding about in flat heels and full skirts.

JUDY B. GILBERT

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Paying for Bank Deposits

Editor, The Wall Street Journal:

Mr. George Shea's article of October 21 took up the possibility of commercial banks once again being allowed to pay interest on demand deposits. One of the arguments, that "an interest return might attract additional funds into the banks, tending somewhat to ease the credit strain," is fallacious. As I believe that the proposed change has some merit, I feel that correct rather than fallacious arguments should be used in examining it.

The error lies in confusing a "bank" and the "banking system." The ability of a bank to lend or invest depends upon the deposits it attracts: hence each bank offers inducements in order to attract depositors. However, the ability of the banking system as a whole to lend or invest depends upon the volume of reserve balances that is made available to the banking system by the Federal Reserve System.

In the present situation, with commercial banks not paying interest on demand deposits, an individual or a corporation with excess deposits can earn a return only by purchasing a security or by making a loan. As pointed out in the article, since 1954 the holdings of Treasury bills (and of other short-term government debt) by non-bank investors has increased at the same time as bank holdings of short-term government debt has decreased. The effect of these changes has been the same as if the banks sold some of their investments to their depositors; bank holdings of government debt and deposits decrease simultaneously.

However, the total reserves of the banks are not affected by these changes, so that banks now have more funds available to lend to other business enterprises. As a result a given quantity of reserve balances and hence of demand deposits can support more business activity—in technical jargon, velocity increases.

Such velocity increases tend to offset the efforts of the Federal Reserve System to restrain expenditures by not allowing commercial bank reserves to increase. Hence, in order to prevent such velocity-increasing substitution of non-bank assets for deposits from being the general reaction of large holders of demand deposits during tight money periods, it is desirable that interest should be paid on large deposits.

The payment of interest on demand deposits by commercial banks would tend to stabilize velocity by fixing the large, which are the volatile, deposits in the banks.

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Art of Government

Editor, The Wall St...

And there was an element of luck, as well as of merit, in the fact that Eisenhower escaped the frozen aloofness which a position of high command develops in some military officers. His warm and folksy personality, his infectious grin, communicated an unusual sense of fellowship to the mer under his command, down to the lowlie private.

When there was a suggestion that Ge eral John J. Pershing, a somewhat wi drawn personality and a stern discipli ian, might be nominated for the Presid after World War I, one hostile commen remarked that this would be a sure w lose four million ex-soldier votes. Jus opposite was the case with Eisenhc strong movements in his favor deve in both major parties.

Favorable Winds

After winning the Republican nom in a close contest with the politically sophisticated Robert A. Taft, Mr. hower again enjoyed good fortune in t cumstances of his first political batt the Democrats.

Public reaction was high in 1952 ag frustrating war in Korea which the T Administration could neither win no So was disgust with evidences of Com infiltration into Government service a deep freezes, mink coats and other of petty corruption in Washington. T tary hero was swept into office on tide of demand for change and bec first Republican to be elected Preside 1928.

And, while the President was f deal with some difficult situations, the rather squalid row between McCarthy and the Army, the Ei luck held pretty well during his years of high office. The death paved the way for a break in the over the Korean War. It proved po few months after Eisenhower's inaug to end the fighting and the casualty a basis of restoring essentially the te status quo, and without any hum compromise of principle, such as the of unwilling prisoners would have beer

Mr. Eisenhower was fortunate in so his economic aides, notably former Sec of the Treasury George M. Humphre former Chairman of the Council of E Advisers Arthur Burns. But the element of luck in the fact that first years of his Administration t living was virtually stabilized, witl in food prices offsetting some i prices of manufactured goods an Far from facing unemployment times, industrial workers, who wages were rising while prices re tionary, "never had it so good," publican swing in many industri 1956 proved.

That Eisenhower had become

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